

REPUTATION RISK

Also known as the Cinderella Asset!

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Presenters

- Dr. Leslie Gaines-Ross, Chief Reputation Strategist at Weber Shandwick in NY where she leads the firm's consulting services and proprietary thought leadership in reputation risk management. She is the creator of www.reputationRX.com, a web site dedicated to reputation issues
- Mr. Scott C. NewQuist, Managing Director at Perception Partners, which specializes in providing advice on identifying and managing reputation risk, corporate governance and reporting.
- Michel Rochette, MBA, FSA, an ERM consultant at Towers Perrin in NY who specializes in ERM and the management of non-tradeable risks!

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Reputation Risk: Agenda

- Context: Why is it important to financial institutions?
- What is reputation? Definitions and comparisons
- Value of reputation: Drivers and evaluation measures
- Reputation risk: Definitions
- Reputation risk: Qualitative and quantitative measures
- Examples of reputation risk
- Reputation risk: Management approaches
- Reputation risk: Framework
- Rating agencies and regulators' points of views
- Questions.

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Citations by Warren Buffet & Goldman Sachs

- “It takes twenty years to build a reputation and five minutes to destroy it.” (W. Buffet)
- “If you lose dollars for the firm, I will be understanding. If you lose reputation, I will be ruthless.” (W. Buffet)
- “Our assets are our people, capital and reputation. If any of these are ever diminished, the last is the most difficult to restore.” (Goldman Sachs Business Principles)

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Importance of Reputation: Trust

- Information asymmetry: Outsiders don't know as much about a company as insiders, so a good reputation alleviates and allow customers to make a choice.
- Important for all companies but crucial and vital to insurers as we sell distant promises: Insurers exchange money for future and unknown promises
- Important for insurers that have one global brand: AIG, ING, Aegon, Met Life, Sun Life, Manu Life, AXA, Allianz, Zurich, Munich Re, Swiss Re, Aflac, etc.
- More important in a period of rapid changes, globalization, internet blogs, activism, mass media.

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Importance of Reputation to Many Decision Stakeholders

- Employees: Are more loyal to a company with good reputation. Help with recruiting.
- Investors and business partners:
 - Will take risk in a company that they can thrust based upon its reputation.
 - More than 90% think about reputation in investment decisions: 40% care about reputation, 50% care partially.
- Lawmakers and regulators: Reputation can help lessen the legal burden on a company.
- Public at large: Preserve "social license" to operate
- Customers and suppliers: Support loyalty to company
- Competition: Barrier to entry

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Corporate Reputation Value: Important to Cos.

- Microsoft: 1st place
- Johnson and Johnson: 2nd
- Google: 4th
- Berkshire Hathaway Inc. 21st
- American Express Company: 34th
- Wells Fargo & Company: 36th
- State Farm Insurance: 42nd
- Allstate: 51st
- No Life companies included. Have your companies rated!
- Consult Fortune's annual survey of America's Most Admired Companies.

Source: National Corporate Survey

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What is Reputation? General Definitions

- A corporate reputation is a collective representation of a firm's past actions and results that describe the firms' ability to deliver outcomes to multiple stakeholders. It gauges a firms' relative standing both internally and externally. (Fombrun /Foss: Developing a Reputation Quotient, 2000)
- Reputation is public information regarding a players' trustworthiness. A players' reputation reflects the information that third parties have on how trustworthy his behavior has been in the past. (Ripperger 1998)

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Comparison of Reputation and Image

- Reputation:
 - Corporate Actions and Conduct that
 - Create Trust
 - As Experienced by different Stakeholders.
 - Serves as a reservoir of goodwill in time of crises.
- Image
 - Belief and personal evaluation of a firm
 - Tied to the firm directly, not to actions by the firm.
 - If image is positive, reputation will improve
 - However, reputation evolves more slowly than image because it is tied to actions.

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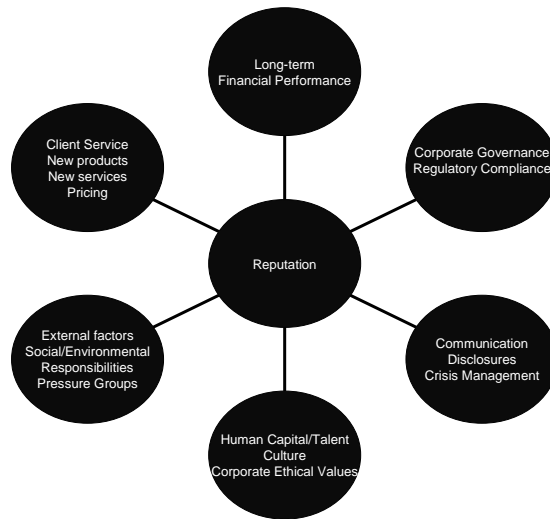
Comparison of Reputation and Brand

- Brand:
 - What differentiates us from the competition
 - Marketing of the company including advertising and publicity
 - Refers to logos and names of companies
- Reputation:
 - Cannot be enhanced by just a name change.
 - Larger concept as it includes other elements as we will see.
 - Often referred as “Emotional Capital” of the firm
 - Thus, if capital, it is subject to risk.

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Corporate Reputation: Value Drivers



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Reputation Drivers Create Value to the Firm

- A good reputation encourages consumers to buy products and services.
- Suppliers are willing to do business with you, thus expanding opportunities.
- Top notch employees want to join and stay with your organization, thus enhancing its innovation capabilities and value.
- Favorable outlook from regulators and rating agencies, thus decreasing financing cost and increasing value.
- Investors want to hold shares, thus increasing value.
- Positive feedback from media and pressure groups increase value.
- In a crisis mode, investors give the company the benefit of the doubt, thus easing short-term decrease in value.

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Reputation Value Subject to Risk: Reputation Risk

- FSA(UK): The risk that the firm may be exposed to negative publicity -Trust - about its business practices or internal controls – Actions -, which could have an impact on the liquidity or capital of the firm or cause a change in its credit rating. -Affecting its stakeholders-.
- US Federal Reserve(2004): “Reputation risk is the potential loss that negative publicity regarding an institution’s business practices, whether true or not, will cause a decline in the customer base, costly litigation, or revenue reductions (financial loss).

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Business Definitions of Reputation Risk

- Regulatory definitions +other business elements:
 - Loss value of key employees.
 - Loss value of key suppliers.
 - Increased cost of regulatory actions.
 - Financial impact of rating agencies’ decisions.
 - Financial impact of litigation resulting from new products
- Consider the positive sides of reputation: Reputation can be enhanced following a well-managed crisis!.
 - Ex. : Tylenol, Sept. 11

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Reputation Risk: A Risk by Itself or a Consequence of Other Risks?

- According to Economist Intelligence Unit(2005) survey, “52% consider reputation risk as a risk by itself, while 48% consider it as a consequence of other risks” like operational risk – people, process, systems and external events – compliance and financial.
- Financial Institutions: Reputation risk appears as a second tier risk.
- Corporate: Risk of its own where emphasis is on their products/services

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Examples: Non financial Sectors

- Catastrophe: Three Mile Island
- Safety Issue: Union Carbide chemical leak in Bhopal in 1984.
- Environmental issue: Home Depot promising to stop selling wood from protected forests after Rainforest Group Action intervention, Exxon Valdez
- Catastrophe: Concorde crash and impact on both Air France (less impact) and British Airways (larger impact due to slow response).
- Product Recall:
 - Tylenol tampering scare in 1982 due to cyanide. Limited impact due to Johnson and Johnson quick responses in the end. In fact, Johnson and Johnson has been rated top in reputation by Harris Interactive.
 - Perrier suffered longer from toluene traces found in its waters due to lack of crisis management.

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Examples: Financial Sectors

■ Scandals/Fraud:

- Arthur Andersen co. fell almost entirely due to the damage to its reputation after Enron's scandal in 2002.
- Interesting case in the field of reputation. Similar to Barings in the field of operational risk.
- One year earlier in 2001, the Chief Executive was saying: "There is extraordinary power in our name because it stands for time-tested values, a unique one-firm global operating approach and recognized superior performance."

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Management of Reputation Risk

- Establish Group Issue Processes. Ex. Swiss Re
- Establish an internal whistle blowing approach. A crisis or an attack on reputation never come at a surprise. Someone knew something within the organization.
- Integrate communications strategies: right message, delivered by right people to right audiences via a mix of channels is critical.
- Economic capital: Integrate reputation impacts into the calculations of other risks, in particular operational risks. In financial industry, 30% feel that they can't quantify while 66% feel that they can quantify in the energy sector.

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Governance of Reputation Risk

- Is reputation risk part of the overall risk policy?
- “Traditional Approach”: CEO is in charge (84%)
 - Reflects focus on crisis management only, reactive
 - Reputation is focused only on organization's own operations.
- Dedicated personnel or dedicated task force
 - CRO, head of business units, communications manager (42%). Reputation risk management is more than PR.
- External parties expect dedicated resources like for the other risks.

Source: Economist Intelligence Unit, 2005

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External Views

- Rating agencies
 - AM Best bases its evaluation on 3 criteria:
 - Balance Sheet Strength
 - Operating Performance
 - Business Profile: Affected by reputation now and in the future. Affected by all reputation risk drivers.
 - Bases its rating on trust in management, enhanced by strong reputation, which is intrinsically linked to its capacity to manage its risk profile.
- Insurance regulators
 - Reputation is a strategic asset of insurers. Each institution should manage it proactively involving the Board and senior management as part of its overall ERM framework.
- US Banking regulators
 - OCC expects that reputation risk management will not be done in isolation but will involve CRO, Board, Audit, Compliance, Customer complaint, HR
 - OCC expects that compensation programs will support desired behaviors

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Thanks

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